

## VIA ELECTRONIC MAIL

November 05, 2012

Ms. Elizabeth M. Murphy  
Secretary  
Securities and Exchange Commission  
100 F Street, NE  
Washington, DC 20549-1090

Re: File Number S7-23-07 – Rule Regarding Principal Trades with Certain  
Advisory Clients

Dear Ms. Murphy:

On October 9, 2012, the Securities and Exchange Commission (SEC) released a request for public comment for a proposal to extend the date on which Rule 206(3)-3T<sup>1</sup> under the Investment Advisers Act of 1940 will sunset.<sup>2</sup> The rule, covering principal trades conducted with certain advisory clients, is scheduled to sunset on December 31, 2012. The proposed temporary rule would extend the sunset date to December 31, 2014.

The Financial Services Institute<sup>3</sup> (FSI) welcomes this opportunity to comment on the proposal, and looks forward to lending additional assistance to the SEC as it reviews the proposed rule extension. We support the extension of Rule 206(3)-3T for an additional two years. We also urge the SEC to consider making the rule permanent as part of its broader effort to harmonize the regulatory requirements applicable to investment advisers

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<sup>1</sup> 17 CFR 255.206(3)-3T.

<sup>2</sup> See the Proposing Release at <http://www.sec.gov/rules/proposed/2012/ia-3483.pdf>.

<sup>3</sup> The Financial Services Institute, Voice of Independent Broker-Dealers and Independent Financial Advisors, was formed on January 1, 2004. Our members are broker-dealers, often dually registered as federal investment advisers, and their independent contractor registered representatives. FSI has 100 Broker-Dealer member firms that have more than 138,000 affiliated registered representatives serving more than 14 million American households. FSI also has more than 35,000 Financial Advisor members.

and broker-dealers<sup>4</sup> in connection with the Dodd-Frank Wall Street Reform and Consumer Protection Act.<sup>5</sup>

### Background on FSI Members

The independent broker-dealer (IBD) community has been an important and active part of the lives of American investors for more than 30 years. The IBD business model focuses on comprehensive financial planning services and unbiased investment advice. IBD firms also share a number of other similar business characteristics. They generally clear their securities business on a fully disclosed basis; primarily engage in the sale of packaged products, such as mutual funds and variable insurance products; take a comprehensive approach to their clients' financial goals and objectives; and provide investment advisory services through either affiliated registered investment adviser firms or such firms owned by their registered representatives. Due to their unique business model, IBDs and their affiliated financial advisers are especially well positioned to provide middle-class Americans with the financial advice, products, and services necessary to achieve their financial goals and objectives.

In the U.S., approximately 201,000 independent financial advisers – or approximately 64% percent of all practicing registered representatives – operate in the IBD channel.<sup>6</sup> These financial advisers are self-employed independent contractors, rather than employees of the IBD firms. These financial advisers provide comprehensive and affordable financial services that help millions of individuals, families, small businesses, associations, organizations, and retirement plans with financial education, planning, implementation, and investment monitoring. Clients of independent financial advisers are typically “main street America” – it is, in fact, almost part of the “charter” of the independent channel. The core market of advisers affiliated with IBDs is comprised of clients who have tens and hundreds of thousands as opposed to millions of dollars to invest. Independent financial advisers are entrepreneurial business owners who typically have strong ties, visibility, and individual name recognition within their communities and client base. Most of their new clients come through referrals from existing clients or other centers of influence.<sup>7</sup> Independent financial advisers get to know their clients personally and provide them investment advice in face-to-face meetings. Due to their close ties to the communities in which they operate

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<sup>4</sup> See Study on Investment Advisers and Broker-Dealers (As Required by Section 913 of the Dodd-Frank Wall Street Reform and Consumer Protection Act) (January 2011), available at <http://www.sec.gov/news/studies/2011/913studyfinal.pdf>.

<sup>5</sup> Pub. L. No. 111-203, 124 Stat. 1376 (2010).

<sup>6</sup> Cerulli Associates at <http://www.cerulli.com/>.

<sup>7</sup> These “centers of influence” may include lawyers, accountants, human resources managers, or other trusted advisers.

their small businesses, we believe these financial advisers have a strong incentive to make the achievement of their clients' investment objectives their primary goal.

FSI is the advocacy organization for IBDs and independent financial advisers. Member firms formed FSI to improve their compliance efforts and promote the IBD business model. FSI is committed to preserving the valuable role that IBDs and independent advisers play in helping Americans plan for and achieve their financial goals. FSI's primary goal is to ensure our members operate in a regulatory environment that is fair and balanced. FSI's advocacy efforts on behalf of our members include industry surveys, research, and outreach to legislators, regulators, and policymakers. FSI also provides our members with an appropriate forum to share best practices in an effort to improve their compliance, operations, and marketing efforts.

#### Comments

FSI supports the extension of Rule 206(3)-3T and commends the SEC and its staff for their thoughtful approach to protecting investors and encouraging continued access to the range of products and services offered by broker-dealers and investment advisers. Since the Court of Appeals for the District of Columbia Circuit's decision in *Financial Planning Association v. SEC*,<sup>8</sup> which vacated Rule 202(a)(11)-1 under the Investment Advisers Act of 1940, broker-dealer firms have relied upon Rule 206(3)-3T as an alternative means to meet the requirements of section 106(3) of the Advisers Act when they act in a principal capacity in transactions with investment advisory accounts. Since the SEC first adopted Rule 206(3)-3T on September 24, 2007,<sup>9</sup> investors have been provided with expanded choice and a wider range of securities at lower costs. The expanded access has also reduced the compliance burden on broker-dealers who would be forced to restructure their operations and client relationships without Rule 206(3)-3T.

Allowing the rule to sunset would increase firms' overhead costs without a corresponding increase in benefits passed on to clients. The costs of allowing Rule 206(3)-3T to sunset would fall heavily on firms who have relied upon it to provide their advisory clients with lower cost and more efficient services through principal trades. Absent the rule, these firms would be required to make significant changes to their internal technology systems, their operations programs, and their supervisory procedures for protecting clients. These internal changes would not provide substantial benefits to investors. Rule 206(3)-3T does not relieve an investment adviser from acting in the

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<sup>8</sup> 482 F.3d 481 (D.C. Cir. 2007).

<sup>9</sup> See Temporary Rule Regarding Principal Trades with Certain Advisory Clients, 72 Fed. Reg. 55022-01, 55023 (Sept. 28, 2007) (17 C.F.R. pt. 275)

best interests of his or her client, or from other applicable provisions of the federal securities laws.<sup>10</sup> Consequently, the rule has not led to significant increases of investment fraud. Since the rule was adopted in 2007 and subsequently extended several times, there has been no evidence of an uptick in securities “dumping” as a result of permitted principal trading made possible by the rule as was envisioned by the rule’s critics.<sup>11</sup>

Allowing Rule 206(3)-3T to sunset would introduce additional costs to investors as well. Investors primarily benefit from principal transactions by having increased access to popular income producing financial products, particularly municipal bonds. Because municipal bonds are typically sold on a principal basis, the rule provides expanded access for individual investors and a wider range of investment choices. FSI’s members increasingly serve the growing segment of the American population planning for retirement, for which municipal bonds are a key product class for inclusion in their investment portfolios. Without the rule investors will be subject to a lag time, where favorable pricing is lost in the time required for the adviser to comply with transaction-by-transaction disclosure and consent requirements. If the rule was allowed to sunset, it would complicate client access to these securities while failing to provide any additional benefit to investors in the form of increased oversight or protection.

FSI favors improvements in transparency and disclosure generally, provided that any new requirements give investors concise unbiased information concerning the most significant factors relevant to their investment decisions while not overloading them with unnecessary information. Additional requirements for adviser disclosure as described in the Proposing Release are unnecessary in light of the absence of evidence that investors are being targeted for abuse under the current rule. One suggested change included in the Proposing Release is to amend Form ADV to require advisers to provide disclosure and descriptions to clients of their reliance on the rule and the compliance policies in place. This amendment would provide little benefit to investors because they are already provided adequate disclosures under the current system. Instead, changes such as these would place an additional

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<sup>10</sup> See 17 CFR 255.206(3)-3T(b) (providing “This section shall not be construed as relieving in any way an investment adviser from acting in the best interests of an advisory client, including fulfilling the duty with respect to the best price and execution for the particular transaction for the advisory client; nor shall it relieve such persons or persons from any obligation that may be imposed by sections 206(1) or (2) of the Advisers Act or by other applicable provisions of the federal securities laws.”).

<sup>11</sup> See Temporary Rule Regarding Principal Trades with Certain Advisory Clients, Investment Advisers Act Release No. 3128 (Dec. 28, 2010) [75 FR 82236 (Dec. 30, 2010)] at Section II. (providing “the staff did not identify instances of “dumping,” a harm that section 206(3) is designed to redress, and we believe that the conditions and limitations in the rule serve as appropriate safeguards during the pendency of the extension”).

regulatory burden on firms to amend their Form ADV filings when their resources would be better spent providing quality services to clients.

We support the SEC's two-year extension; however, we believe that a permanent extension of Rule 206(3)-3T will provide the best outcome. As the SEC moves toward establishing a uniform fiduciary standard for investment advisers and broker-dealers, it may be useful to look to the success of Rule 206(3)-3T as an example of successful harmonization of other regulatory requirements. FSI supports the adoption of a new universal fiduciary standard of care that requires advisers to act in the best interest of their customers, to disclose or avoid when possible material conflicts of interests, to obtain informed customer consent when such conflicts cannot be reasonably avoided, and to provide quality advice and services based upon the adviser's reasonable diligence. Accordingly, the approach taken by Rule 206(3)-3T conforms to these principles and can be a model for further progress in this area of securities regulation.

#### Conclusion

We remain committed to constructive engagement in the regulatory process and, therefore, welcome the opportunity to work with the SEC on investor protection and an efficient regulatory environment for independent broker-dealers and independent financial advisors.

Thank you for your consideration of our comments. Should you have any questions, please contact me at [REDACTED]

Respectfully submitted,

A handwritten signature in black ink, appearing to read "D. T. Bellaire". The signature is fluid and cursive, with a large initial "D" and "T" and a smaller "Bellaire" following.

David T. Bellaire, Esq.  
Executive Vice President & General Counsel